determining value where a carrier is, in effect, forced to sell property to others. See Procedures for Implementing the Detariffing of Customer Premises Equipment and Enhanced Servs., 48 Fed. Reg. 29891, 29896-97 (CC Docket No. 81-893) (June 29, 1983).

By preventing incumbent LECs from recovering the full costs associated with their networks, the Commission's "TELRIC-plus" pricing falls far short of satisfying constitutional standards. First and foremost, the Commission's pricing method fails, by design, to recover incumbent LECs' historical costs. Rather, it allows only for recovery of the forward-looking incremental costs associated with network elements that incumbent LECs must unbundle. The investments an incumbent LEC has actually made in constructing its network, however, must be recovered if the company is to provide a return to investors sufficient to continue attracting capital. In effect, by ignoring historical costs the Commission's pricing standard accomplishes a taking without compensation of the incumbent LECs' embedded, invested capital.[2]

It is no answer to these concerns to argue that forward-looking incremental costs provide the proper measure for determining prices that would prevail in a competitive market. The Constitution is not concerned with setting prices at the level that would be fixed if a hypothetical market with perfect competition existed. Rather, it is concerned with preventing the imposition of confiscatory rates. That standard requires taking into account the actual costs a regulated business incurred in constructing the facilities it is required to provide for others' use.

---

[2]In contrast to the Commission's approach, state commissions that have used forward-looking costs to price unbundled elements in accordance with the Act have also recognized the need to allow recovery of all of the LEC's investment and common costs. See, e.g., Conn. DPUC Docket No. 95-06-17, at 75-76 (Dec. 20, 1995); Conn. DPUC Docket No. 95-11-08, at 5 (July 17, 1996).

Even if it were permissible under the Constitution for a pricing system to preclude recovery of historical costs, it must -- at a minimum -- allow incumbent LECs full recovery of their joint and common costs. The Commission's pricing methodology, however, fails to meet even that standard. Under the Commission's method of determining costs, incumbent LECs are allowed only what the Commission terms a "reasonable allocation" of joint and common costs. But that allocation does not even purport to recoup the full joint and common costs of incumbents' networks. Cf. First Report and Order ¶ 696. In addition, incumbents must be allowed to recover amounts currently built into charges for some of their services that are designed to subsidize other aspects of their service. To the extent that, under the new regulatory framework under the Act, incumbent LECs will still be required by law to provide services that are currently subsidized, and to provide them without rebalancing their rates (i.e., to continue providing the service at a rate that fails to cover costs), they must be allowed to recover the costs of providing those subsidized services from other sources in the charges they are permitted under the Act.

C. The Commission Acted Arbitrarily and Capriciously in Setting Default Proxy Prices.

Even putting to one side the flaws in the Commission's pricing standards outlined above, the Commission committed further errors in setting default proxy prices under the Act. Congress spelled out a process for ensuring the compliance of individual agreements with the terms of the Act -- and particularly the pricing terms of the Act -- in arbitrations supervised by state commissions. By design, the arbitration process under the Act involves fact-specific decisionmaking tied to the circumstances presented in individual cases. By attempting to arrive at default proxy prices in a rulemaking instead -- and an abbreviated rulemaking at that -- the

Commission has thoroughly circumvented the process outlined in the Act. The expedited procedures in this rulemaking, indeed, could hardly be further from the individualized decisionmaking that would characterize arbitrations. Parties, after all, were not even given an opportunity to comment on the Commission's rules before they were published. By setting out proxy prices, therefore, the Commission not only usurped the role assigned to state commissions over pricing, but also deprived parties of the fact-specific, adjudicative process Congress envisioned for arbitrations under the Act. By short-circuiting the case-specific consideration for each party's circumstances that Congress guaranteed, the Commission's rules have violated both the Administrative Procedure Act and the Due Process Clause.

Moreover, the Commission's attempts to rely on generalities to promulgate "proxy" prices in this expedited rulemaking have only led to further errors. For example, after outlining a detailed method for measuring costs and setting prices, the Commission proceeded to set proxy prices based on studies that used <u>different</u> methods for determining costs or measured costs only for a fraction of the element being priced as defined by the Commission. Indeed, in setting prices for unbundled loops, the Commission failed to provide any reasoned explanation connecting the studies on which it relied either to its own "TELRIC-plus" method or to the proxy prices ultimately imposed. The Commission's blithe disregard for the very methods it prescribed and its failure to explain the ultimate price levels it chose present the paradigm of arbitrary and capricious agency action.

The Commission's errors are best illustrated by its selection of prices for unbundled loops in Florida. The Commission explained that it was setting proxy prices based on two cost models and on the rates set for unbundled loops by six states, including Florida, that had already conducted actual cost studies. See First Report and Order ¶ 792. The cost studies, however, and particularly the Florida studies, were not based on the Commission's "TELRIC-plus an allocation for joint and commond costs" method. To the contrary, the Florida studies used a measure of costs that omitted any significant contribution for joint and common costs. See Affidavit of Dennis B. Trimble ("Trimble Aff.") ¶¶ 5-14; see also FPSC Docket No. 950984-TP, Order No. PSC-96-0811-FOF-TP. Despite the obvious discrepancies between the standards used in Florida and its own methodology, the Commission made no effort to explain how the Florida studies might properly be used in setting rates that would comply with the Commission's announced approach.

The Commission only compounded its error by choosing, again without explanation, a proxy rate for Florida that could not logically be reconciled with the very studies on which the Commission purportedly relied. Based on the studies presented to it, the Florida commission approved loop prices that produced an overall state weighted average price of $17.28. Given the standards used in the Florida cost studies, the Commission's announced pricing method by definition would logically require an average loop price greater than $17.28. Nevertheless, without any further explanation linking the price it selected to the Florida studies (or linking the studies to its own pricing standards), the Commission set the average proxy rate for loops in Florida at $13.68 -- over 20% below the average rate set by Florida. On its face that result cannot be squared with the Florida studies, one of the few actual pieces of evidence concerning costs on which the Commission claimed it had relied. By declining to offer any rationale to explain this facially illogical result, the Commission utterly failed to live up to the requirements of reasoned decisionmaking. See, e.g., Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins.

Co., 463 U.S. 29, 43 (1983). For all that appears from the explanation presented in the First Report and Order, the Commission might just as well have picked the default prices out of a hat.

The results in Florida, moreover, are merely the clearest example of an arbitrary approach repeated in setting all the proxy prices for unbundled loops. The Commission nowhere explained how cost studies based on different measures of costs were adjusted to reflect the measure required under TELRIC or how the exact proxy prices were calculated based on those studies and the Commission's two models. By failing to establish any clear rationale linking the evidence before it to the ultimate numbers it chose, the Commission acted arbitrarily.

The Commission similarly failed to measure up to the standards of reasoned decisionmaking in setting the proxy prices for unbundled switching. As defined by the Commission, the unbundled end office switching element includes not only the basic switching function of connecting lines and trunks but also the full range of "features, functions, and capabilities of the switch," First Report and Order ¶ 412, including "vertical switching features, such as custom calling and CLASS features," id. ¶ 410. See also § 51.319(c). The studies on which the Commission relied to set proxy prices, however, had explicitly examined the costs associated solely with providing a much more narrowly defined switching function. These studies, in fact, focused on the costs associated merely with transporting additional minutes of traffic from an interconnecting carrier across the local switch. See, e.g., Trimble Aff. ¶¶ 17, 18. The studies, thus, did not even purport to address the costs associated with providing end users the full functionality present in a local switch. Moreover, the studies considered only the incremental cost of additional minutes of traffic and made no attempt to measure average costs. Accordingly, the studies made no allowance for recovering overheads and fixed costs associated with the switch as explicitly allowed by the Commission's own description of the TELRIC method. See Trimble Aff. ¶¶ 9, 15-20; Affidavit of Timothy J. Tardiff ¶¶ 2-14. Nevertheless, the Commission once again failed to acknowledge the discrepancies between the evidence on which it was relying and its own definitions of both the network element in question and the proper measure of costs. In the absence of any effort to provide a rationale connecting these studies to the Commission's announced definitions, the Commission's reliance the studies as the source of proxy prices is utterly arbitrary.

D. Additional Specific Requirements Imposed by the Commission's Rules Violate the Plain Language of the Act.

The Act establishes specific ground rules for the pricing of resold services and exchange access services. The Commission's rules, however, frequently ignore the plain language of the Act and sanction or require evasions of pricing principles enacted by Congress. The following are some of the most prominent ways in which the Commission's rules conflict with the express terms of the Act:

1. Evasion of Resale Limitations and Access Charges

The Commission interprets the Act as allowing a requesting carrier to obtain unbundled network elements and "reassemble" them into the equivalent of resold services and/or exchange access services. In so doing, the Commission essentially nullifies the resale and exchange access provisions of the Act in several respects.

(a). Evasion of Resale Category Limitations. Section 251(c)(4)(B) prevents a requesting carrier from obtaining wholesale rates based on a service that an ILEC sells exclusively to one category of customer and using that rate to serve another category of customer. This provision ensures that, for example, low residential basic local rates are not mandatorily discounted and then offered by resellers to business customers, who cannot obtain those favorable rates from the ILEC. The Commission's "reassemblage" policy, however, allows a requesting carrier to "create" the functional equivalent of a resold service without being bound by these service category limitations.

(b). Evasion of Access Charge Pricing Requirements. Section 251(g) of the Act expressly states that, until the Commission undertakes comprehensive exchange access reforms, LECs will provide exchange access in accordance with the same "restrictions and obligations (including receipt of compensation) that apply" on the date of enactment of the Act. This provision makes clear that section 251 interconnection is not intended to serve as a substitute for exchange access service, which is governed by pre-existing provisions in the Communications Act. Notwithstanding this explicit requirement, the rules adopted by the Commission allow interconnecting carriers to evade current provisions concerning exchange access charges by providing themselves exchange access through unbundled network elements.

2. Defining Wholesale Rates Based Upon "Avoidable" Costs.

Section 252(d)(3) of the Act expressly provides that wholesale rates for resold services will be established by excluding costs "that will be avoided by the local exchange carrier." The Commission's order, however, defines wholesale rates to exclude costs to the incumbent local exchange carrier that are either "avoided" or "avoidable" costs. See First Report and Order ¶ 911. "Avoided" costs are those that the carrier actually avoids in offering a service for resale as opposed to "avoidable" costs that they theoretically could avoid, but do not. The rewriting of the Act to apply an "avoidable" costs test flies in the face of the statute's plain language.

3. Defining Vertical Services as Unbundled Elements to Place Them Under Different Pricing Standards.

Vertical services are offered today as services to end users rather than network elements comprising the LEC's telecommunications infrastructure. Despite this fact, the Commission's order stretches the Act's definition of "network element" beyond all recognition to include not only the "physical" elements in the network, but also vertical services offered by incumbents to the public and the "information" used by incumbents in providing services. See, e.g., First Report and Order ¶¶ 410, 412-13. This evasion of the Act's pricing standards and rewriting of key definitions is clearly inconsistent with the express language of the statute that requires unbundling of physical elements of the network, not individual services offered from the existing network.

4. Requiring ILECs to Make Investments and Modify Their Networks with Inadequate Compensation.

In a number of different situations, the Commission has required ILECs to make significant modifications to their networks to accommodate requests from interconnectors without prescribing adequate methods of compensation. Rather than requiring the "unbundling" of physical elements of the network as provided in section 251(c)(3), the Commission goes beyond the Act's provisions to require ILECs to provide interconnection at a different level of quality from that normally associated with the network, see First Report and Order, ¶¶ 225, 382, and even to unbundle services, see id. ¶ 536.

II. GTE AND SNET WILL SUFFER IRREPARABLE HARM ABSENT A STAY BECAUSE THE NEW RULES WILL IRREVOCABLY ALTER THE OUTCOME OF NEGOTIATIONS AND STATE ARBITRATIONS UNDER THE ACT AND WILL RESULT IN THE LOSS OF REVENUE, CUSTOMERS AND GOODWILL.

If allowed to become effective, the Commission's rules will cause immediate and irreparable harm to GTE and SNET in at least two significant respects. First, the rules will have an irreversible adverse impact on scores of negotiations and binding arbitration proceedings currently under way pursuant to § 252. Second, by requiring incumbent LECs to offer unbundled elements and resold services at below-cost rates, the rules will cause incumbents to suffer irremediable losses of revenue, market share, and customer goodwill.

A. The Commission's Rules Will Immediately Dictate the Terms of Ongoing Voluntary Negotiations and State Arbitrations.

The Commission's rules -- and particularly its pricing standards -- will immediately have a dramatic effect on both the terms open for discussion and the ultimate outcome of negotiations currently under way under § 252 of the Act. By providing a detailed set of default terms that the parties will expect to apply in arbitration, the rules will, as a practical matter, take a host of issues off the bargaining table from the outset and drastically reduce the scope of private negotiations. For example, the Commission's default pricing levels will remove virtually any incentive for a requesting carrier to negotiate concerning pricing. See Affidavit of Donald W. McLeod ("McLeod Aff.") ¶ 9; Affidavit of Anne U. MacClintock ("MacClintock Aff.") ¶ 22. In the absence of default terms, parties would likely bargain about various pricing levels in exchange, for example, for terms concerning volume commitments or the length of the agreement. Discussion on those issues, however, is largely preempted by the rules, which provide a baseline from which bargaining can move in only one direction.

The Commission, in fact, has acknowledged the deadening impact its rules will have on negotiations as it has suggested that the rules would serve as a "useful guide for negotiations," First Report and Order ¶ 60, or would "expedite negotiations" by "narrowing the potential range of dispute," id. ¶ 41. The bottom line underlying this language is clear: negotiations will naturally be speedier where many terms are effectively set in advance. Indeed, the Commission itself has recognized more straightforwardly that the rules "may serve as a de facto floor or set of minimum standards that guide the parties" in negotiations. Notice of Proposed Rulemaking, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 61 FR 18311- 03, at ¶ 20 (CC Docket No. 96-98) (Apr. 19, 1996) (emphasis added). Similarly, in adopting default pricing proxies the Commission declared that "[t]he default proxies we establish, will, in most cases, serve as presumptive ceilings." First Report and Order ¶ 768.[3] Given the Commission's own predictions, therefore, there can be no doubt that the rules will have an immediate impact on negotiations.

Indeed, even before the Commission's rulemaking was complete, the mere expectation that the rules would soon be in place had a marked detrimental effect on the bargaining process. For example, after weeks of serious negotiations, a comprehensive understanding between GTE and Sprint was scuttled in part because it was anticipated that the Commission's pricing proxies would provide Sprint more advantageous terms. See McLeod Aff. ¶ 11. Similarly, SNET's negotiations with TCG, which had been scheduled for August 14-15, 1996, were abruptly

[3]It seems likely that this prediction will be borne out in many arbitrations since some requesting carriers are already suggesting that state commissions should apply the Commission's default prices without conducting any further proceeding to receive evidence on incumbent LECs' costs. See McLeod Aff. ¶ 14; MacClintock Aff. ¶ 22.

postponed after the First Report and Order was released. See MacClintock Aff. ¶ 22. Obviously, if the Commission's rules take effect, the immediate impact on current negotiations will be dramatic. See McLeod Aff. ¶¶ 8-9.

The rules' stifling effect on negotiations will only be aggravated by the Commission's conclusion under § 252(i) that requesting carriers must be granted access to any individual interconnection, service, or network element arrangement on the same terms contained in an agreement with any other carrier. See First Report and Order ¶ 1314. This extreme version of a "most favored nation" requirement will severely impair meaningful negotiations. See McLeod Aff. ¶ 9. Balancing give and take on various issues to reach an integrated agreement with any particular carrier will be a largely futile endeavor if any concession on an individual term will automatically be available to other carriers, without regard to further terms on which the concession may have been based. Moreover, under the Commission's rules a competing carrier can take advantage of its "most favored nation" status to claim the terms from another agreement without going through the standard procedures for § 251 requests. Such a carrier can instead seek the terms offered to others on an "expedited basis." First Report and Order ¶ 1321. By combining the ability to cherry-pick individual terms from other agreements with such an option for avoiding negotiations altogether, the Commission's rules only create further incentives for requesting carriers to short-circuit the negotiating process.

Finally, the impact of the Commission's rules on negotiations will be further exacerbated by the strict timetables imposed by the Act. After a carrier makes an interconnection request, that carrier and the incumbent have only 135 days to negotiate an agreement before either party may seek binding arbitration. See § 252(b)(1). Once requested, arbitration must be concluded within nine months of the original interconnection request. See § 252(b)(4)(c). GTE is currently in the midst of negotiating dozens of interconnection agreements pursuant to § 252(a)(1) in twenty-eight states. See McLeod Aff., Ex. 1. In several instances, the initial 135-day period will expire within the month.[4] Id. In other instances, the 26-day period during which petitions for arbitrations must be filed will expire even sooner.[5] Id. In still other cases, petitions for arbitrations have already been filed and the arbitrations must be resolved soon. McLeod Aff., Ex. 2. Similarly, SNET is involved with negotiations or arbitrations with seven requesting carriers, and decisions in these proceedings will also be required in the next several months. See MacClintock Aff. ¶¶ 14, 22, Ex. 2. Impending deadlines imposed by the Act only put increased pressure on the parties to treat the Commission's rules as the presumptive terms for their entire agreement. As a practical matter, if the rules take immediate effect, there will be no incentive for any requesting carrier to agree to any terms -- and in particular to any pricing terms -- less favorable than the presumptive terms adopted by the FCC.

As a result, if the rules are not stayed pending review, GTE, SNET and other incumbent LECs will be forced to choose between two uninviting alternatives. They may enter into "privately negotiated" agreements whose terms are, in reality, dictated by the Commission's rules, or they may have similar terms imposed on them by state Commissions. In the event that some of the regulations are later struck down, incumbents such as GTE and SNET will have lost

[4]For example, the 135th day of GTE's negotiations with MCI in several states was reached on August 17, 1996. Many other negotiations will soon reach the 135th day milestone as well. See McLeod Aff., Ex. 1.

[5]For example, the negotiations with AT&T in Arizona, California, Florida, Hawaii, Illinois, and several other states will reach the 160th day on August 19, 1996. See McLeod Aff., Ex. 1.

forever the opportunity to conduct voluntary negotiations with competing carriers free from the influence of a set of presumptive terms dictated by the Commission's unauthorized rules. The loss of such bargaining opportunities in itself constitutes an irreparable injury. See Carson v. American Brands, Inc., 450 U.S. 79, 87-88 & n.14 (1981) (loss of the opportunity to compromise on mutually agreeable terms is irreparable);[6] Local Division 732, Amalgamated Transit Union AFL-CIO v. Metropolitan Atlanta Rapid Transit Auth., 519 F. Supp. 498, 500 (N.D. Ga. 1981) (lost bargaining opportunities constitute harm of an irreparable nature), vacated on other grounds, 667 F.2d 1327 (11th Cir. 1982).

Even if the current rules are overturned, it will not be possible to undo the harm to incumbents such as GTE and SNET. Even if it were possible to bargain for terms allowing renegotiations if the rules are struck down, it would be impracticable, if not impossible, to undo the effects that the rules would have on scores of agreements negotiated or arbitrated under their shadow. It is unrealistic to think that after incumbents have agreements in place with dozens of carriers they will be able to restart negotiations from scratch and open up for consideration the full range of options that would be possible when the parties approach the table on blank slate. Once agreements based on the rules are in place, companies will structure their business plans around those agreements. Decisions about investments in technology, reconfigurations of the network, reassignment of personnel, and the provisioning of service offerings that are possible

---

[6]In American Brands, the Court ruled that a district court's denial of a motion to enter a consent decree should be immediately appealable because the loss of the opportunity to settle cases on mutually agreeable terms short of litigation is a "serious, perhaps irreparable consequence" of the district court's refusal to enter a consent decree. This consequence was particularly harmful where Congress had expressed a strong preference for encouraging voluntary settlement of Title VII claims. Id. 88 n. 14. Here, too, Congress has expressed its strong preference for voluntary negotiations between incumbent LECs and competing carriers.

and profitable will all become set. See Affidavit of Barry W. Paulson ("Paulson Aff.") ¶¶ 5-7. Customer expectations under new service arrangements similarly will solidify. Once these changes take place, it will not be possible for parties simply to scrap the working arrangements they have in place to go back to square one under a new set of rules. Rather, they will be largely committed to the course dictated by the initial rules and will be able to adapt only by half measures if the rules are struck down.

In addition, to the extent that agreements could be renegotiated to take into account changed rules, all parties would incur substantial and unnecessary costs that could not be recouped. See McLeod Aff. ¶ 4. All of these harmful consequences would be avoided, of course, if the rules were stayed for the brief period required for review in the Court of Appeals.

B. The Commission's Rules And Pricing Standards Will Result in an Irremediable Loss of Revenue, Customers and Goodwill.

In addition to losing bargaining opportunities and being yoked with largely irreversible commitments dictated by the rules, GTE and SNET will also suffer an immediate loss of customers, goodwill and revenue if the rules go into effect. The national pricing standards promulgated by the FCC will immediately allow competitors to undercut incumbent LECs' retail rates. Implementing the pricing standards thus will cause GTE and SNET to suffer a loss of market share or a loss in revenue as they attempt to cut rates to meet competitors' artificial pricing advantage.

As outlined above, the Commission's pricing method not only excludes from consideration historic costs and a full measure of joint and common costs, it also assumes that costs should be measured based on a hypothetical network that uses only the most efficient available technology. The pricing system thereby allows requesting carriers simultaneously the benefit of ignoring actual costs that come with operating a network and the benefit of receiving prices that reflect not only the full economies and efficiencies that an incumbent LEC has achieved, but the efficiencies of a hypothetical most efficient LEC. Cf. First Report and Order ¶ 11. As a result, the Commission's default prices systematically offer requesting carriers prices below actual costs. By thus shielding requesting carriers from bearing the true costs of a network, the Commission's rules can only have the effect of artificially spurring entry by competitors whose own inefficiencies will be, in effect, subsidized by below-cost pricing. The result must necessarily be a loss of revenue and market share for incumbents.

To outline one example, the default proxy prices the Commission has set for unbundled loops universally ensure that GTE cannot recover its actual loop costs. In Florida, for instance, the Commission set a state-wide average price ceiling of $13.68 for unbundled loops. See First Report and Order, App. D. As explained above, however, see supra p. 20, even under cost studies that were based on a TSLRIC measure of costs and that virtually excluded all recovery of joint and common costs, the Florida Public Service Commission (PSC) had set prices for loops that produced an average rate of $17.28 and a loop price of $20.00 specifically for GTE. See First Report and Order ¶¶ 792-93. Given the overly narrow measure of costs the Florida PSC employed, those rates systematically understate costs even as compared to the Commission's own "TELRIC-plus" definition. Yet the Commission's proxy price is over 30% below even GTE's forward-looking costs as determined in Florida.

When the proxy rate is compared to GTE's actual costs, including its embedded costs, the discount is even more dramatic. The proxy rate, in fact, is a full 45% below the average cost of GTE's loops as determined in the NECA separations process. See Affidavit of Duane G.

Johnson ("Johnson Aff.") ¶¶ 5-6, Attachment 1. See also Universal Service Fund 1995 Submission of 1994 Study Results by NECA (CC Docket NO. 80-286) (Sept. 29, 1995) (Tab 8).[7] Competitors who obtain access to unbundled loops at anything approaching this wholly artificial price obviously will be able to offer local exchange service at a discount from GTE's rates,[8] thereby ensuring that GTE will suffer a loss in market share.

The Commission's proxy prices for unbundled end office switching similarly will prevent GTE from recovering its actual costs. Even if 17% of the costs of an end office switch are attributed to retail expenses, the Commission's proxy prices of $0.002 to $0.004 per minute would not allow GTE to come even close to recovering the full costs of a switch if those prices were applied to all the minutes of use of the switch. See Trimble Aff. ¶¶ 19, 20, Attachment 1.[9] Any interconnecting carrier purchasing only a part of the capacity of the switch under the proxy prices, therefore, would not be paying for its full share of the costs. Rather, it would effectively be getting the full set of features and functions from the switch at a price well below the cost GTE incurs itself.

---

[7]Similar discounts far below GTE's actual costs are reflected in the default prices for loops in every state. Indeed, the Commission's default price is more than 25% below GTE's costs for every state except Nebraska. See Johnson Aff., Attachment 1.

[8]It is true that the proxy rate sets an average ceiling for the state that will not necessarily be imposed directly on GTE. See § 51.513(c)(1). Nevertheless, since the Commission's ceiling for the average is 21% below the average that resulted from the Florida commission's order, it follows that loop prices for individual incumbents will also necessarily be lower than those set by Florida.

[9]The unreasonableness of both the wholesale discount rate and the proxy price ceilings is demonstrated by a comparison of the actual costs for wholesale operations of an incumbent LEC computed using the Commission's discount rate applied to today's cost-based prices, to the revenues that would result from the Commission's proxy prices. See Johnson Aff. ¶¶ 7-12, Attachment 2.

The wholesale discount rates specified by the Commission for resold services once again will allow competitors to undercut GTE and SNET since they overstate the discounts properly required under the Act. The Commission has determined, for example, that interim wholesale rates set by a state commission must be at least 17% below an incumbent LEC's retail rate. See § 51.611(b). But the Commission arrived at this dramatic discount only by concluding that the discount should include not only "avoided" costs, as required by the Act, but also "avoidable" costs. See First Report and Order ¶ 911.[10] In contrast, after applying a "retail rates minus avoided cost" standard to set wholesale rates, the State of California concluded that only a 12% discount from retail rates should be required. See id. ¶ 899. The additional 5% discount mandated by the Commission would ensure potential entrants a price advantage that could only accelerate an incumbent's loss of customers.

The Commission's rules also introduce yet another factor that will compound immediate pressure on GTE from the Commission's pricing standards and artificially accelerate the loss of customers. The Commission directs state regulators to implement geographic deaveraging of the prices of unbundled elements. See § 51.507(f). At the same time, however, the Commission makes no provision for rebalancing retail rates on a geographic basis. As a result, requesting carriers will immediately be able to take advantage of incumbents' lower costs in densely populated urban areas since those costs must be reflected in lower prices for unbundled elements. Incumbent LECs, on the other hand, will only be able to restructure their retail prices to reflect varying costs after going through a state rate proceeding. The difference in the

[10]The Commission also treated all of the costs recorded in USOA account 6623 (customer services) as presumptively avoided costs. But that account includes costs relating to services for IXCs that are clearly not avoided retail costs.

wholesale and retail pricing frameworks will thus vastly enhance competing carriers' ability to skim customers in low cost, high margin urban areas. Precisely such a disjunction between wholesale and retail prices would likely be avoided, moreover, if the Commission left responsibility for pricing where Congress assigned it -- with the state commissions.

There can be no doubt that the discounts at which GTE and SNET will be required to offer unbundled elements and resold services will cause immediate losses of customers. The price sensitivity of demand for local service is such that a rival who offers even a slight discount from an incumbent's rates can cause the incumbent to suffer a loss in market share. The greater the discount, of course, the greater the decrease in market share. Taken together, the Commission's various below-cost pricing rules will result in losses of market share for GTE, SNET, and other incumbent LECs. The losses resulting from this subsidized competition, moreover, will be permanent. See Wisconsin Gas Co. v. FERC, 758 F. 2d 669 (D.C. Cir. 1985). As AT&T's recent competition with MCI aptly illustrates, once market share is lost, it can only be partially recovered and only at great cost. AT&T, for example, spent over $870 million to regain just 1% of its market share, at a rate of $51.18 per customer. See Advertising Age 3-5 (Jan. 30, 1995).

In addition to the number of lost subscribers, GTE and SNET will suffer nonquantifiable damage to goodwill as a result of the Commission's rules, which will allow rivals to undercut their prices and effectively hobble their ability to compete. See MacClintock Aff. ¶ 18. Such unrecoverable losses of goodwill are also routinely recognized as forms of irreparable injury justifying a stay. See, e.g., Multi-Channel TV Cable Co. v. Charlottesville Quality Cable Operating Co., 22 F.3d 546, 552 (4th Cir. 1994) ("[W]hen the failure to grant preliminary relief creates the possibility of permanent loss of customers to a competitor or the loss of goodwill, the irreparable injury prong is satisfied.").[11]

Finally, to the extent that GTE and SNET begin providing services or access under pricing standards that are later struck down, they will incur losses in interim revenue. Obviously, as they lose customers to competitors who pay only the artificially low, below-cost prices set by the Commission for unbundled elements, incumbents such as GTE and SNET will lose retail revenues. Moreover, there will be no way to recover such losses since neither the competing carriers nor the Commission could be required to make GTE or SNET whole even if the rules are later struck down. As the Commission has repeatedly recognized, the threat of such non-recoverable economic loss constitutes irreparable harm justifying a stay pending review. See, e.g., Battlefield Cable TV Co., 10 FCC Rcd 10591 (Cab. Serv. Bur., 1995) (granting stay of refund order where revenues refunded would be unrecoverable); Cablevision of New York, 10 FCC Rcd 12279 (Cab. Serv. Bur. 1995) (same).

III. A STAY PENDING JUDICIAL REVIEW WILL NOT HARM OTHER PARTIES.

A stay pending judicial review will not harm new competitive entrants, other incumbent local exchange carriers or members of the public. First, as the Act envisions, competitive entry into the local exchange marketplace will move forward on schedule through private negotiations, mediations and arbitrations. Second, if the rules are ultimately upheld, agreements can be

[11]Basicomputer Corp. v. Scott, 973 F.2d 507, 512 (6th Cir. 1992) ("[T]he loss of customer goodwill often amounts to irreparable injury because the damages flowing from such losses are difficult to compute"); See K-Mart Corp. v. Oriental Plaza, Inc. 875 F.2d 907, 914 (1st Cir. 1989)(upholding injunction where harm consisted of lost sales and a detriment in the store's presentation to the public); Gateway Eastern Ry. Co. v. Terminal R.R. Ass'n of St. Louis, 35 F.3d 1134, 1140 (7th Cir. 1994) ("[S]howing injury to goodwill can constitute irreparable harm that is not compensable by money damages.").

readily modified to include the Commission's prescribed national standards. Thus, American consumers will receive the benefits of local exchange competition consistent with statutory deadlines and the congressional goal of promoting economically sound investment and entry.

A. Local Exchange Competition Will Move Forward on Schedule as Envisioned by the Act.

A stay will cause no harm to other parties because the Commission's rules are not critical for the transition to local competition under the Act to go forward. Under the terms of the Act, private negotiations between carriers serve as the primary means for introducing competition into local telecommunications. See § 252(a). Those negotiations can proceed unimpaired under a stay because negotiated agreements are not subject to the requirements of § 251. See § 252(a)(1). As a result, there is simply no need for the Commission's rules to be in place for parties to reach agreements under § 252(a).

For precisely that reason, many private negotiations have already gone forward and many were nearing completion before the Commission announced its regulations. See McLeod Aff. ¶¶ 11, 12. The vast majority of the work involved creating local competition can thus be achieved by private parties without the Commission's rules being in place. Indeed, it would be ironic for potential entrants in the market to argue that any delay at all in the Commission's regulations will necessarily harm them, when the paramount emphasis in the Act was to allow private negotiations to create the new market in local telecommunications largely unfettered by detailed federal regulations.

Of course, where private negotiations fail, the Act provides for arbitration to ensure compliance with the requirements of § 251. See § 252(b). Arbitrations, however, are explicitly entrusted to the states, see id., and there is no reason to think that state commissions will be unable to fulfill the role Congress assigned them without detailed national standards fixed by the Commission. To the contrary, experience already shows that state commissions can implement the pro-competitive requirements of the Act without the exhaustive rules dictated by the FCC. In Connecticut, for example, the state commission has already implemented extensive requirements concerning interconnection, unbundling, and resale and has determined that the vast majority of its rules already fully comply with the substantive standards of the Act. See MacClintock Aff. ¶¶ 4-16.

Thus, arbitrations will go forward, and state commissions will ensure compliance with the substantive standards of § 251 even if the Commission's rules are stayed for the relatively brief period required for expedited review in the Court of Appeals.

B. Agreements Can Be Revised If the Rules Are Upheld.

Even if the rules are ultimately upheld, there will be no substantial harm to parties who may have arbitrated agreements in the interim. To the extent the interpretations of § 251 imposed by state commissions do not precisely conform to the details of the Commission's regulations, parties will certainly be able -- indeed required -- to conform their agreements to the Act as interpreted by the Commission.[12] Moreover, it will be far easier for parties to conform any variations in arbitrated agreements to the Commission's rules if the rules are later upheld than it would be for parties to re-work agreements adopted under the rules if the rules are struck down. Thus, it would require little effort to bring arbitrated agreements into line with federal rules, especially since state commissions will already have ensured compliance with the

[12]The Commission has even determined that it would be a per se failure to negotiate in good faith for parties to refuse to accept provisions allowing agreements to be amended to take into account changes in the Commission's rules. See First Report and Order ¶ 152.

substantive requirements of § 251 and § 252. On the other hand, however, after deals have already been struck and a system of agreements based a uniform mold is in place and network alterations have been made, it will be impossible to recreate the atmosphere of free negotiations that would exist as parties approach the bargaining table from scratch. Parties with working agreements inevitably will have reduced incentives to incur the transaction costs involved in renegotiation, and even if they can change their agreements on some vital matters, it would be fanciful to think they would reopen discussions on the full range of issues that would be on the table were they starting from a blank slate. In short, truing up any local variations to federal standards would be a vastly simpler task than attempting to move from an entrenched system of uniform agreements to create, after the fact, a system of particularized negotiation that never existed in the first place.

Finally, far from a stay causing harm, it is more likely that the absence of a stay would harm parties such as requesting carriers. Absent a stay, requesting carriers will structure their business plans and investments, their service offerings, and their commitments to customers according to the arrangements that are profitable under the Commission's mandated standards. To the extent the rules are later struck down and incumbents seek to escape the more burdensome terms imposed by the Commission, requesting carriers' expectations will be disrupted and they will incur substantial costs replanning services and restructuring facilities to adapt to the altered calculus that must govern their decisions absent the Commission's rules.

IV. THE PUBLIC INTEREST FAVORS A STAY.

The 1996 Act embodies a clear congressional judgment that the national interest favors the rapid and efficient introduction of competition in the local exchange. In this case, the public interest in achieving that goal would best be furthered by a stay.

As explained above, privately negotiated agreements backed by state arbitrations are the key mechanism Congress chose to facilitate the growth of local competition. A large number of private negotiations had been taking place after the Act became effective, but before the Commission issued its Order; these negotiations would continue even in the face of a stay pursuant to the direct mandates of Sections 251 and 252 of the Act. All sides to these negotiations are motivated to continue with the negotiations either for their own business reasons or because of the legal obligations created by the Act. New entrants will push forward to take advantage of their new business opportunities in the local exchange service market and ILECs will want to earn fair compensation for interconnection arrangements through negotiated agreements or, if negotiations fail, through state arbitration decisions. A stay pending review is thus entirely consistent with the public interest, since the system for creating local competition under the Act can go forward as Congress envisioned whether or not the Commission's regulations are in place.

If a stay is denied, however, there is a substantial risk that progress toward competition will be gravely impaired due to the false start created by the Commission's unlawful rules. In the first place, the system of free, private negotiation that Congress built into the Act will be permanently short-circuited. As the Commission itself has recognized, parties negotiating against a backdrop of comprehensive regulations will undoubtedly treat the regulations as a floor setting minimum requirements for their "voluntary" agreements. Negotiations will thus be skewed as the regulations operate as a one-way ratchet setting the opening terms for discussion. Once agreements are reached under this system, if the regulations are later overturned, it will be effectively impossible for parties to turn back the clock and rework the agreements they have reached.

Even if it would be possible for parties to revisit their agreements, renegotiations could only be accomplished through a massive waste of time and resources. Hundreds of agreements would have to be reworked in an effort that would approximate a second restructuring of the industry. Indeed, if the rules are struck down considerable expenditures on attempted renegotiations may be inevitable since it will be virtually guaranteed that some carriers will have entered agreements under business plans or technological agreements that would prove unprofitable under a revised set of rules. The giant backward step involved in returning to ground zero to renegotiate agreements would produce dislocations and delays that would substantially impede progress in creating the fully competitive local telecommunications market promised by the Act.

New entrant interests will also be served by avoiding the significant displacement that will occur by operating under the Commission's rules for a period of time, just to have them reversed later. This would upset new entrant network development and business plans. Network element and resale pricing are so low that they will encourage entry by companies that would not normally enter if they had known the true costs involved. While the new entrant has already committed itself to substantial capital investments, with their attendant business risks, a court reversal would dramatically alter the profitability and risk assessments for the entrant and its investors. The public interest is not served by this "on again, off again" business climate, which will damage not only the new entrant and its investors, but will also discourage future entrants who will view this regulatory volatility negatively even when more even-handed rules are eventually put into place.

The general public also will be protected rather than harmed by grant of the stay request. As noted above, competitive entry will proceed on schedule bringing the associated benefits of local exchange competition. American consumers will be protected, however, from uneconomic entry due to artificial and unlawful regulatory pricing rules.

The public interest in this case thus clearly favors a stay. Staying the regulations for the relatively brief period required to permit judicial review in the limited circumstances sought here will allow private agreements and arbitrations fostering competition to go forward precisely as Congress planned. Denying a stay, however, would carry the risk that, if the Commission's rules are overturned on review, the entire industry would engage in a massive wasted effort by establishing interconnection arrangements pursuant to the Order's mandates. In addition, consumers, new entrants and GTE and SNET would suffer substantial disruption from unscrambling the unlawful tangle of network element and resale pricing created by the Commission.